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IN THE

Supreme Court of the United States

OCTOBER TERM 1953

No. [redacted] 37

MARION L. HOLLAND AND ETHEL E. HOLLAND, *Petitioners*,

v.

UNITED STATES OF AMERICA

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioners, Marion L. Holland and Ethel E. Holland, by their counsel, pray that a writ of certiorari issue to review the judgments of the United States Court of Appeals for the Tenth Circuit, affirming the judgments of the United States District Court for the District of Colorado.

OPINIONS BELOW

The District Court wrote no opinion. The opinion of the Court of Appeals (R. 341-352) is reported at 209 F. 2d 516.

JURISDICTION

The judgments of the Court of Appeals were entered on January 21, 1954 (R. 352). An order denying a petition for rehearing was entered on February 5, 1954 (R. 74). An order staying the mandates of the Court of Appeals to March 7, 1954, was entered on February 8, 1954 (R. 374). On March 3, 1954, an order was entered by Mr. Justice Clark extending the time for the filing of a petition for writ of certiorari to March 22, 1954. On March 5, 1954, an order was entered by the Court of Appeals staying its mandates until March 22, 1954. The jurisdiction of this Court is invoked under 28 U.S.C. Section 1254.

QUESTIONS PRESENTED[1]

1. Absent any evidence of any specific unreported item of income, of any undisclosed source of income, or of any improper or unallowable deduction, may a criminal conviction for tax evasion, based entirely on a net worth computation, be sustained where the Government has failed to establish with reasonable certainty the net worth starting point, omitting from such starting point, among other things, substantial stock holdings as well as a critical item of cash, the existence or non-existence of which was admitted by the Government's principal witness to be a matter of doubt?

2. Where a taxpayer's books and records are complete and admittedly do not contain a single error which would result in an understatement of taxable income, may the Government substitute a different method of accounting,

[1] In the event that this petition is granted petitioners would desire to present for the Court's consideration the following additional questions.

1. In a criminal tax evasion prosecution based upon net worth expenditures computations, is the Government required to prove that the taxpayer received *taxable* income in excess of that reflected on his income tax return and that a tax is due and owing?

2. Was the evidence sufficient to sustain the conviction of either of the petitioners?

in this case the net worth method, and rely upon its net worth computation as the sole evidence to support a tax evasion prosecution?

3. (1) Did the lower court improperly limit the Government's burden of proving the crime charged to that of merely discrediting the taxpayer's extra-judicial statement relating to the opening net worth?

(2) May the Government shift to the taxpayer the burden of establishing the items which should or should not be included in the taxpayer's opening net worth?

4. In a criminal tax evasion prosecution based entirely on circumstantial evidence, may the trial court refuse to give the jury any instruction whatsoever to the effect that the defendant must be acquitted if the proof is not such as to exclude every reasonable hypothesis other than that of guilt?

5. May the trial court refuse to instruct the jury upon the section of the statute which forms the basis of the indictment?

6. Is it proper to instruct the jury that the reasonable doubt which would require a verdict of acquittal in a criminal case is the "kind of doubt" which the jury "*might be willing to act upon* in their more serious and important affairs", as distinguished from an instruction to the effect that the doubt must be of a kind which would lead the jury *to hesitate to act* or *refrain from acting*?

STATUTES INVOLVED

Internal Revenue Code:

Sec. 41. General Rule.

> The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in

keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 48 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year. (26 U.S.C. 1946 ed., Sec. 41)

Sec. 145 (b). Penalties.

Failure to collect and pay over tax, or attempt to defeat or evade tax. Any person required under this chapter to collect, account for, and pay over any tax imposed by this chapter, who willfully fails to collect or truthfully account for and pay over such tax, and any person who willfully attempts in any manner to evade or defeat any tax imposed by this chapter or the payment thereof, shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, be fined not more than $10,000, or imprisoned for not more than five years, or both, together with the costs of prosecution. (26 U.S.C. 1946 ed., Sec. 145 (b).

STATEMENT

The petitioner Marion L. Holland, was indicted under Section 145 (b) of the Internal Revenue Code for willfully and knowingly attempting to evade and defeat income taxes for the years 1946 and 1947 by filing or causing to be filed false and fraudulent income tax returns. (R. 7-8).

Petitioner and his wife, petitioner Ethel E. Holland, were indicted under Section 145 (b) of the Internal Revenue Code for willfully and knowingly attempting to evade and defeat income taxes for the year 1948. Petitioner Marion L. Holland, was acquitted as to the years 1946 and 1947. Both petitioners were convicted on the

charge that they had willfully attempted to defeat and evade income taxes for the year 1948 (R. 8-9, 12).

The nature of the Government's case was described by the Court of Appeals as follows (R. 342):

> The returns for each of the prosecution years were prepared by a tax accountant from books and records kept by him from information furnished by appellants. There is no contention that the returns do not accurately reflect all of the income shown on the books and records maintained by the taxpayers in the course of their business as owners of a hotel and restaurant in Golden, Colorado. There is no direct proof of any specific unreported item of income or undisclosed sources of income, or that any items of expense claimed as deductions were not legitimate and allowable. The government's case rests solely on the circumstances of increased net worth established by record purchases and expenditures during the prosecution period to prove a substantial understatement of taxable income for those years.

During the years 1946, 1947 and 1948 the petitioners operated a hotel in Golden, Colorado, which was acquired by Mr. Holland on April 1, 1946.

A joint tax return was filed by Marion L. Holland and Ethel E. Holland for the year 1948, reporting income of $11,211.42, with a total tax paid thereon of $1,532.52 (R. 251). This return, as were the individual returns filed by petitioner Marion L. Holland for the years 1946 and 1947, was prepared by Dwight Dulaigh, a tax consultant, from the books and records of the petitioners which he kept (R. 152). In addition to the permanent books and records, a daily record showing disbursements and receipts in cash and by check for the operation of the hotel was supplied to Mr. Dulaigh by the petitioners for the purpose of computing their taxable income (R. 153). Not only the permanent books and records of the petitioners, but also the daily cash reports which were prepared each day, were all available to the Government during its investiga-

tion, and to the court during the trial (R. 88, 89, 159, 161). Attached to the daily report sheets were cash "paid-out" slips representing receipts for whatever cash was paid out for any particular item (R. 159-161). These receipts were also available to the Government. When an expenditure was made, not by cash but by check, there was a stub and a cancelled check to show the nature of the expenditures (R. 159-161). These checks were also available to the Government (R. 159-161). The record is destitute of any evidence of any specific unreported income, of any undisclosed source of income, or of any improper or unallowable expenditure (R. 342). The record is similarly devoid of any evidence that petitioners' books and records were incomplete or inadequate for the purpose of truly reflecting taxable income on the basis of the method of accounting employed by the petitioners (R. 342). The only inaccuracy relating to petitioners' income tax returns resulted in an overstatement of petitioners' income in that they failed to claim depreciation with respect to certain items of hotel equipment and fixtures purchased between March 19, 1948, and May 12, 1948. The fact of the purchases, however, was reflected in petitioners' checks (R. 158, 160-161).

The Government's case was based entirely upon net worth computations. The Government fixed the petitioners' opening net worth on the 1st day of January, 1946 at $19,152.59, consisting of bank account balances in the amount of $2,152.09, corporate stock having a cost basis of $29,650.00, less certain liabilities (R. 181). Based on record purchases and expenditures and starting with the figure of $19,152.59, the Government purported to show an increased net worth for the year 1946 in the amount of $54,863.09; for the year 1947 in the amount of $29,516.17; and for the year 1948, the year now involved, in the amount of $28,743.62 (R. 180-85). The indictment relating to the year 1948 charged the petitioners with understating their

income for that year by approximately $18,000, resulting in an asserted unpaid tax liability of $7,518.88 (R. 342).

The petitioners did not take the stand on their own behalf. They did, however, give to the Government investigator during the course of the investigation certain sworn statements in which they fixed their net worth on January 1, 1946, as $156 or $157 thousand (R. 71-72), consisting of $104,000 in cash accumulated prior to December 22, 1933 (R. 71-72, 82, 303); $9,000 in cash accumulated subsequently from salaries (R. 71), and the balance in corporate stock (R. 71). The Government sought to meet its burden of proof by introducing evidence as to certain visible assets and liabilities on January 1, 1946, by introducing evidence of subsequent expenditures and purchases, by introducing the sworn statements above referred to, and by introducing circumstantial evidence relating to the petitioners' past financial history and tending, according to the Government's theory, to show that the petitioners were in fact not affluent during the early years involved and could not have accumulated a cash fund (R. 343-347).

In computing the petitioners' opening net worth on January 1, 1946, the Government included no part of the $113,000 cash fund claimed by the petitioners to have existed at that time in their extra-judicial statements (R. 180-181). The only corporate stock included in the net worth of petitioners on January 1, 1946, was that stock, the subsequent sale of which was reflected in petitioners' income tax return (R. 180-181, 347).

The Government's special agent who conducted the investigation stated that the petitioner Marion L. Holland had told him that part of the cash fund which he had accumulated consisted of money obtained when he turned in about $10 to $20 thousand in gold to various banks pursuant to the President's call. According to the Government's special agent the petitioner identified the banks

by name, which included the Colorado National Bank. The special agent stated that he did not inquire at any of these to determine whether or not gold was in fact turned in for cash by the petitioners (R. 86-87). The petitioner had further indicated to the special agent during his investigation that a large part of the cash accumulated was a result of real estate transactions in the 1920's when he was buying and selling real estate at a profit in Denver County (R. 93-94). The Government's special agent testified that he personally did not check into the records of the County Clerk and Recorder of Denver County to determine which properties were bought and sold by Mr. Holland (R. 94), and that he did not know whether anyone else had made such a check. The petitioner further had told the Government's special agent that approximately $15,000 in cash was accumulated as a result of certain restaurant sales. The special agent testified that he had made no check of the records to determine the number of sales or the selling price (R. 99).

With respect to the currency, no part of which was included by the Government in its opening net worth statement, the Government's special agent testified as follows:

> *The only question of cooperation which I have in mind was whether they always told us the truth about their currency, or not.* (R. 85)

With respect to petitioners' security transactions, Mr. Glenn W. Davis, Cashier of the United States National Bank of Denver, testified for the Government that his bank made loans to Mr. Holland from 1942 to 1946 (R. 25); that these loans were secured by a pledge of corporate stocks (R. 26); that at the end of the year 1945, the outstanding balance on the loans was secured by the following corporate securities (R. 26-30):

Date of Pledge	Shares Pledged	Corporation	Record
1- 3-42	300	Southern Pacific Company	26
5-27-42	200	Midland Steel	27
5-27-42	200	Curtis Publishing Company	27
5-27-42	100	Nash-Kelvinator	27
5-27-42	100	Commercial Credit	27
7- 3-42	100	Columbia Broadcasting Company	27
12-29-42	100	Midland Steel	27
1-25-43	100	20th Century Fox	27
7-27-43	100	Midland Steel	27
7-27-43	100	20th Century Fox	27
1- 6-44	400	20th Century Fox	27
3- 6-44	100	20th Century Fox	28
9- 5-44	500	United Gas	28
9- 5-44	1000	Commonwealth & Southern	28
10-13-44	50	United Gas	28
10-28-44	100	Certainty Products	28
11- 8-44	600	Certainty Products	28
5- 1-45	200	20th Century Fox	28
5- 1-45	100	Sinclair Oil	28
12-14-45	100	Sinclair Oil	28

Mr. Elmer C. Penny, Vice-President of the Wyoming National Bank at Casper, Wyoming (R. 140-144), a Government witness, testified that his bank had made a loan to Mr. Holland, in the name of "Francis M. Monroe" on July 18, 1938, in the sum of $1,450.00 (R. 141); that the loan was secured by 200 shares of Paramount Pictures Corporation stock and 100 shares of New York Central Railroad stock (R. 141); that the loan was paid July 29, 1948 (R. 141); that a second loan was made September 6, 1938, in the sum of $1,070.92 (R. 141-142); and that this loan was secured by 100 shares of New York Central Railroad stock (R. 141) and 100 shares of Southern Pacific Railroad stock (R. 142), and was paid September 15, 1938 (R. 142).

Mr. Robert B. Bryans, Vice-President of the Casper National Bank (R. 130-132), a Government witness, testified that his bank had made eight loans (R. 131) to Mr. Holland from September 1937 to April 1938 ranging from $200.00 to $2,194.38 (R. 131). All these loans were secured by stock as follows (R. 131-132):

Date of Pledge	Shares Pledged	Corporation	Record
9-15-37	50	20th Century Fox	131-132
3- 7-38	100	Warner Bros.	131-132
3- 7-38	100	Warner Bros.	131-132
9-27-38	100	North Central Railway	131-132
10-15-38	100	Western Union	131-132
12-30-38	50	Holly Sugar	131-132
12-30-38	300	Nash Kelvinator	131-132

Mr. George C. Bodley, the special agent of the Bureau of Internal Revenue, testified as follows (R. 95, 96):

> Q. So that before January 1, 1946 he had bought and sold at a profit many shares of corporate stock, is that right?
>
> A. Yes, he did. His greater purchases were still on hand in 1946. He held stock then.

The only proof in the record of the actual sale of any portion of the corporate stock owned by petitioners is reflected in Schedule "D" (R. 239) attached to the income tax return of Mr. Holland for the year 1946. It is there indicated that on February 2, 1946, blocks of 20th Century Fox Film stock and blocks of Midland Steel Products Company stock were sold for a total of $52,151.78. Schedule "D" does not recite the number of shares sold.

With respect to the failure of the Government to account for all of the stock which its witnesses had indicated was in existence on or at some time before January 1, 1946, the Court of Appeals stated as follows:

> . . . Subsequent returns for the period in question did not reflect the sale of any stock. If, therefore, any stocks remained unsold in 1946, they must be assumed to have remained in his custody and could therefore have no bearing on his net worth as established by purchases and expenditures. (R. 347)

The Government's case against petitioner Ethel E. Holland was based solely on the theory that any unreported income must have been the result of an understatement of gross receipts; that the petitioner Ethel E. Holland pre-

pared the daily sheets showing the gross receipts and turned them over to the bookkeeper; and that, therefore, the evidence was sufficient for the jury to conclude that Mrs. Holland had violated the statute, notwithstanding the failure of the Government to demonstrate a single discrepancy in any daily report prepared by Mrs. Holland (R. 193, 198).

REASONS FOR GRANTING THE WRIT

The decision of the Court of Appeals raises several questions of substantial importance, particularly in the prosecution of criminal tax evasion cases, and is in conflict with a number of decisions of other Courts of Appeals.

(a) The decision of the Court of Appeals is in conflict with decisions in three other circuits holding that where the prosecution attempts to establish an understatement of income by the net worth method, the case should not be submitted to the jury if the starting point net worth is not definitely established. *Bryan* v. *United States*, 175 F. 2d 223 (CA 5), affirmed without considering the point in issue here, 338 U. S. 552; *United States* v. *Fenwick*, 177 F. 2d 488 (CA 7); *United States* v. *Calderon*, 207 F. 2d 377 (CA 9) petition for a writ of certiorari now pending before this Court (No. 577). *In the Calderon petition the Government states that the Calderon case is "inconsistent in principle with [the] holding" in the case at bar* (p. 9, *Government's Petition*).

(b) The decision of the Court of Appeals conflicts in principle with the decision of the United States Court of Appeals for the Ninth Circuit in *Remmer* v. *United States*, 205 F. 2d 277, reversed on other grounds, 22 L. W. 4142. Contrary to the decision below, the Court of Appeals in the *Remmer* case, while upholding the taxpayer's conviction, expressly recognized the principle, that "The net worth method of computing income may be used only where a taxpayer does not keep books or such books are inade-

quate in that they do not clearly reflect income." (p. 286) In this respect the decision is further in conflict with decisions of the United States Tax Court, *Glackman* v. *Commissioner*, 10 T.C.M. 1132 (1951); *Thomas A. Taley* v. *Commissioner*, Tax Court Docket Nos. 33,140 and 33,141, June 30, 1953, 20 T.C. No. 101, and in probable conflict with applicable decisions of this Court, *Pacific National Co.* v. *Welch*, 304 U. S. 191; *United States* v. *American Can Company*, 280 U. S. 412.

(c) In limiting the Government's burden to that of discrediting a defendant's extra-judicial statement, thus requiring the defendant to establish his own net worth starting point, the decision of the Court of Appeals marks a significant departure from established principles of proof in criminal cases; and is inconsistent in principle with the dicta contained in recent decisions of the Courts of Appeals for the Third and Fifth Circuits. *United States* v. *Caserta*, 199 F. 2d 905 (CA 3); *United States* v. *Demetree*, 207 F. 2d 892 (CA 5).

(d) The decision of the Court of Appeals is in conflict with decisions of the Courts of Appeals for the Fifth, Sixth, Seventh and Eighth Circuits holding or acknowledging the principle that where a criminal case is based entirely upon circumstantial evidence, the trial court is required to give some form of instruction to the general effect that the evidence must be inconsistent with every reasonable hypothesis but that of guilt. *Garst* v. *United States*, 180 Fed. 339, 343 (CA 4); *Stutz* v. *United States*, 47 F. 2d 1029 (CA 5); *Anderson* v. *United States*, 30 F. 2d 485, 487 (CA 5); *Bryan* v. *United States*, *supra*, p. 226; *Strickland* v. *United States*, 155 F. 2d 167, 168 (CA 5); *McLendon* v. *United States*, 13 F. 2d 777, 779 (CA 6); *Epstein* v. *United States*, 174 F. 2d 754, 769 (CA 6); *United States* v. *Fenwick*, 177 F. 2d 488, 490 (CA 7); *Gurera* v. *United States*, 40 F. 2d 338, 340 (CA 8); *Banks* v. *United States*, 204 F. 2d 666, 672 (CA 8).

(e) The decision of the Court of Appeals is in conflict with decisions of the Courts of Appeals for the Third and Ninth Circuits holding, contrary to the decision here, that the trial court is required to instruct the jury with respect to the statute governing the offense and not merely as to the factual elements set forth in the indictment. *United States* v. *Pincourt*, 159 F. 2d 917 (CA 3); *United States* v. *Levy*, 153 F. 2d 995 (CA 3); *United States* v. *Noble*, 155 F. 2d 315 (CA 3); *Morris* v. *United States*, 156 F. 2d 525 (CA 9).

(f) The decision of the lower court upholding an instruction on reasonable doubt as the "kind of doubt" the jury "*might be willing to act upon* in their more serious and important affairs" is in conflict with every State court appellate decision in which such instruction has been considered. *Commonwealth* v. *Miller*, 139 Pa. 77, 21 Atl. 138; *State* v. *Rover*, 11 Nev. 343; *People* v. *Bemmerly*, 87 Cal. 117, 25 Pac. 266; *Lovett* v. *State*, 30 Fla. 142, 11 So. 550, all to the effect that reasonable doubt is that doubt which would lead reasonable men to *refrain from acting* or *hesitate to act*, rather than the converse set forth in the instruction here.

The several questions raised in this petition are of substantial importance in the proper administration of the criminal laws and are of particular importance in the administration and enforcement of the Federal Revenue statutes. The precise questions are arising with great frequency among the lower courts as a result of the increasing tendency of the Internal Revenue Service and the Department of Justice to resort to and to rely wholly upon the net worth expenditures method as a basis for tax evasion prosecutions. In the light of the inherent crudeness of the net worth method as a basis for criminal conviction, and the lack of uniformity among the lower courts, a clarification of the basic principles to which the courts must adhere in such cases is now required by this Court.

ARGUMENT

A. The Necessity for Establishing the Net Worth Starting Point With Reasonable Certainty.

The Government completely failed to prove the petitioners' net worth starting point with reasonable certainty—a requirement that was particularly incumbent upon it in the light of the fact that there was absolutely no evidence of any specific unreported item of income, of any unallowable deduction, or of any undisclosed source of income (R. 342). The Government fixed the petitioners' net worth as of January 1, 1946, at $19,152.59, from which it purported to demonstrate unaccounted for increases in net worth for the years 1946, 1947, and 1948. The figure of $19,152.59 admittedly included only those corporate stocks, the subsequent sale of which was reflected in petitioners' income tax returns (R. 347). In fixing petitioners' opening net worth on January 1, 1946, the only cash included by the Government as an asset was the sum of $2,153.09, consisting of balances in two bank accounts (R. 181). In the petitioners' extra-judicial statement made to the special agent of the Bureau of Internal Revenue, they claimed to have had on January 1, 1946, approximately $113,000 in currency (R. 71-73). The lower courts, as well as the Government, took the view that "the ultimate and precise issue" was whether the jury believed beyond a reasonable doubt "that there was no such fund in existence on January 1, 1946." According to the Court of Appeals the petitioners' "guilt or innocence turned on a resolution of those issues (relating to the cash fund)." (R. 351) Notwithstanding this, the special agent for the Bureau of Internal Revenue—the chief Government witness—testified with respect to the petitioners' currency as follows (R. 85):

> "The only question of cooperation which I have in mind was whether they always told us the truth about their currency, *or not*." (Emphasis added)

In view of the doubt specifically expressed by this witness with respect to this critical item, it is apparent that the Government failed to sustain the burden, imposed upon it in all pure net worth expenditure cases, of proving the taxpayer's net worth starting point with reasonable definiteness. With respect to this item of currency the present case is similar to *Bryan* v. *United States, supra*, where the Court of Appeals, in reversing the conviction of the lower court, observed (p. 226):

> "But we cannot escape the fact that Mr. Marquis, the auditor, frankly admitted that he did not know whether his computation contained all the assets of the Defendant *or not*." (Emphasis added)

Furthermore, the evidence produced by the Government's witnesses clearly established that either on or before January 1, 1946, the petitioner Marion L. Holland was the owner of hundreds and possibly thousands of shares of stock (R. 29-30; 141-142; 130-132). With respect to this stock, the special agent of the Bureau of Internal Revenue testified that the petitioners' "greater purchases were still on hand in 1946." (R. 95-96) Having proven through its own witnesses the existence of these securities on or before January 1, 1946, the Government completely failed to take into consideration any securities except those, the disposition of which was reflected in the petitioners' income tax return for the year 1946 (R. 239, 347). The Government did not even take into consideration in its net worth computations the 300 shares of stock which the record irrefutably established were owned by the petitioners as of July 29, 1948. The court below attempted to meet this obvious defect by making the following observation (R. 347):

> "The representative of the bank where the stocks were pledged for loans testified that all the stock pledged for collateral was liquidated or withdrawn early in 1946, and thereafter all other loans were secured by deeds of trust. Subsequent returns for the period in

> question did not reflect the sale of any stock. If, therefore, any stocks remained unsold in 1946, they must be assumed to have remained in his custody and could therefore have no bearing on his net worth as established by purchases and expenditures."

In thus disposing of the petitioners' contention the court below ignored the principle that the Government must prove the opening net worth with reasonable certainty. Certainly the fact that the stock was liquidated *or withdrawn* does not establish its non-existence on January 1, 1946. Nor is there any basis for the court's assumption that any stock which had not been sold prior to 1946 necessarily remained in the petitioners' custody and had "no bearing on his net worth." Unless a gain was realized on a subsequent disposition of a stock no duty would have been imposed upon the petitioner to report the transaction on his income tax return. Moreover, the stock could have served as collateral for the borrowing of additional funds. The important consideration, however, is that the court below found it necessary to fill in an obvious gap in the Government's case by speculating as to the possible subsequent disposition of securities which were proven to have existed on or before January 1, 1946, and which were neither accounted for by the Government nor taken into consideration in the net worth statement. With respect to these securities the present case is similar to *United States* v. *Fenwick*, *supra*, where the Court of Appeals, in reversing the lower court, observed (p. 491):

> "The agent testified that defendant had certain corporate stock but the prosecution offered no proof as to the amount owned by defendant in 1942 or whether any part or all of it was sold in 1943 or in 1944."

In addition to the critical affirmative deficiencies apparent in the Government's net worth starting point, the evidence also established that the Government's investigation was defective. The special agent who conducted the investiga-

tion stated that he made no inquiry at the banks where petitioners had informed him they had turned in gold for cash (R. 86-87); that he did not check into the records of the County Clerk of Denver County to determine whether or not, in fact, properties were bought and sold by Mr. Holland at a profit as indicated in his statement (R. 94); that he made no check of the records to determine whether or not it was true that petitioners had realized substantial profits as a result of certain restaurant sales (R. 99).

The courts have recognized that the proof of a criminal tax evasion case by reliance on the net worth method is fraught with potential peril. The divergence of approach, however, by the various United States Courts of Appeals has become extreme. *The Government has expressly stated in the Calderon petition for certiorari previously referred to that the Calderon case is "inconsistent in principle" with the holding in the present case (p. 9, Government's Petition).* The present case is also in sharp conflict with *Bryan* v. *United States*, *supra*, and *United States* v. *Fenwick*, *supra*, and is inconsistent in principle with the dicta in *United States* v. *Caserta*, 199 F. 2d 905, 907 (CA 3), and *Demetree* v. *United States*, 207 F. 2d 892, 893-894 (CA 5).[2]

The assumption that the difference between the amount of assets at the beginning and end of a particular year constitutes taxable income is a somewhat speculative assumption under all circumstances. The assumption certainly cannot be made when the special agent in charge of the investigation admits doubt as to the existence or non-existence of the critical currency item. It certainly

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[2] "Sometimes, without adhering to the essentials of the method, that the net worth at the beginning as well as the end of the period be shown, the proof comes in and the case is submitted with a complete gap in the proof as to the beginning of the period.

"This kind of latitudinous allowance of the admission and use of conclusions as evidence and the submission of the case to the jury without a scrupulous adherence to the theory has resulted in a tendency to accept, if not in the complete acceptance of, the idea that in a case tried by this method, ordinary rules of proof may be relaxed if not disregarded. . . ."

cannot be made when the Government's own evidence establishes the existence of several hundred or thousand shares of securities and fails to account for the disposition of these securities or to take them into consideration in its net worth computation.

The time has come to reiterate and give force to the principle that the preservation of a defendant's constitutional rights is of greater importance than the easing of the Government's difficulties in a tax evasion prosecution where it has no direct evidence of fraud.

B. The Impropriety of Resort to the Net Worth Expenditures Method Where the Taxpayer's Books and Records Are Complete and Are Not Shown to Contain a Single Inaccuracy Which Would Result in the Understatement of Taxable Income.

The court below made the following relevant observation with respect to the nature of the present case:

> "The returns for each of the prosecution years were prepared by a tax accountant from books and records kept by him from information furnished by appellants. There is no contention that the returns do not accurately reflect all of the income shown on the books and records maintained by the taxpayers in the course of their business as owners of a hotel and restaurant in Golden, Colorado. There is no direct proof of any specific unreported item of income or undisclosed sources of income, or that any items of expense claimed as deductions were not legitimate and allowable. The government's case rests solely on the circumstances of increased net worth established by record purchases and expenditures during the prosecution period to prove a substantial understatement of taxable income for those years."

In addition to the permanent books and records, all the daily records showing disbursements and receipts in cash and by check for the operation of the petitioners' business were available to the Government during its investigation and to the Court during the trial. No inaccuracy was shown

in any of the books or records of a character which would have resulted in the understatement of taxable income. Under such circumstances, there was no evidence upon which the Government's case could have been properly submitted to the jury, for resort to the net worth method of computing income was inappropriate.

In upholding the conviction here based entirely on net worth evidence, the court below ignored the requirements of Section 41 of the Internal Revenue Code. Section 41 by its terms limits the authority of the Government to deviate from the method of accounting selected by the taxpayer to situations where no method of accounting has been employed in keeping a taxpayer's books or where the method employed does not reflect taxable income. While the position of the petitioners here is in many respects similar to that taken by the petitioner in the *Remmer* case, *supra*, the Court of Appeals in the *Remmer* case, contrary to the decision here, expressly recognized the principle that "the net worth method of computing income may be used only where a taxpayer does not keep books or such books are inadequate in that they do not clearly reflect income . . ." (p. 286). The same position appears to have been adopted by the Tax Court which, in *Glackman* v. *Commissioner*, *supra*, after citing cases holding that there may be resort to the net worth method where the taxpayer fails to produce adequate records, made the following statement:

> "This case, however, differs from those cases and others in which the increase in the use of net worth has been sustained. In this case, the petitioner's principal source of income was from sales at his barroom. As to those sales, he had records and the respondent did not find error in them in determining the deficiency, nor through any evidence at the trial, although there was considerable examination of witnesses as to the accuracy of the records."

Further, the precise question here involved appears to have been raised in *Olson* v. *United States*, 191 F. 2d 985

(CA 8), and *Chang Sing Ho* v. *United States*, 186 F. 2d 574 (CA 9). In the *Olson* case the taxpayer "objected to the evidence of net worth on the ground that it 'constituted a mere substitute method in the absence of books, the government having already established that there were adequate books kept for the year' " (p. 987). The Court of Appeals in stating that it found no merit in this assignment of error made the following statement:

> "As the defendant kept a set of books for 1946 the government in the first instance determined his correct income and his attempt to evade the tax on it on the basis of the books. But it rightly sought *to corroborate and check its conclusion* by reference to other available evidence tending to support its accusation and to show the same tax evasion . . ." (p. 987). (Emphasis added)

The clear implication of the Court's observation is that where the taxpayer keeps adequate books, the net worth computation may be used only as corroborative evidence. In the *Chang Sing Ho* case, the Court of Appeals for the Ninth Circuit avoided passing upon the issue by holding that "in any event there was competent evidence that the books and records . . . were basically inadequate" (p. 575).

This Court, while not dealing with the precise question involved here, has held that even in situations where individual items or entries upon the books are shown to be in error, the Government is not thereby permitted to substitute a method of accounting different from that employed by the taxpayers. *United States* v. *American Can Co., supra; Pacific National Co.* v. *Welch, supra.*

In the light of the confusion among the lower courts and the increasing recurrence of the question, it is important that this Court consider and determine whether the Government may base a criminal tax prosecution entirely on net worth computations where the taxpayer keeps adequate books and records, where there are no errors on the books which would result in the understatement of income,

and where there is no specific evidence of unreported income, of unallowable deductions, or of undisclosed sources of income. The danger in resorting to the so-called net worth expenditures method under such circumstances is perhaps best illustrated in connection with the conviction here of Mrs. Holland. The Government's case against her was based on the following assumptions:

a. That there was an unaccounted for increase in net worth for the year 1948;

b. That the unreported income must have been the result of an understatement of gross receipts, there being no other potential source of income; and

c. That since the petitioner Ethel E. Holland prepared the daily sheets showing the gross receipts and turned them over to the bookkeeper, she must have at least aided and abetted a violation of Section 145(b) (R. 193, 198).

It is unlikely that in any other field of criminal law a conviction would be allowed to stand on such a pyramid of speculation.

C. The Burden of Proof Was Improperly Shifted From the Government to the Taxpayer.

The Government viewed its burden in this case as that of disproving or discrediting the extra-judicial statements made by the petitioners to the investigators prior to the trial. In an effort to accomplish this the Government introduced a wealth of circumstantial evidence tending, under its theory, to discredit the petitioners' statements to the effect that they had accumulated a substantial cash fund in prior years. A reading of the trial court's instruction, as a whole, leaves no doubt but that the effect of the instruction was to indicate to the jury that the petitioners' guilt or innocence turned upon whether the

Government had, in fact, succeeded in discrediting the petitioners' extra-judicial statements as to the existence of a cash fund. Thus, the trial court instructed the jury as follows (R. 212-13):

> ". . . Some emphasis was made in the arguments to you, Ladies and Gentlemen of the Jury, that there was no evidence here that any statement on the income tax returns for '46, '47, and '48 has been shown to be false. *That isn't the issue in this case.* The issue in this case is whether or not these defendants filed those income tax returns, reporting the income on those returns and the tax computed from it, knowingly and wilfully not including gross receipts from the business which the Government claims they earned, and which the Government claims they didn't report.
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> "The government proceeds upon the theory that there was no such cash fund of a hundred and four thousand dollars, or a hundred and thirteen thousand dollars, and that the increases in their net worth each year were the result of purchases from receipts earned in the taxable years in question from that business. That is the government's position."
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> "If you believe, Ladies and Gentlemen of the Jury, and are satisfied beyond a reasonable doubt that the Government's evidence that Mr. Holland and Mrs. Holland did not have that cash fund, or any other source of the money with which they increased their net worth except the gross receipts of this business in the taxable years in question then you should bring in a verdict of guilty, if you also find Ladies and Gentlemen of the Jury that they have proved to your satisfaction beyond a reasonable doubt, all of the essential and material elements of the charges in this indictment." (Emphasis added)

The trial court, in effect, made the issue of guilt or innocence depend solely upon whether the petitioners did or did not possess a cash fund sufficient to explain their subsequent purchases. Accordingly, the trial court narrowed the burden imposed upon the Government from that

of proving all of the essential elements of Section 145 (b) to that of merely discrediting the petitioners' extra-judicial statement as to the accumulation of a cash fund. The court below specifically adopted the view of the trial court in stating that it "agree[d] with the trial court that the ultimate and precise issue in the case was whether they believed beyond a reasonable doubt from the established circumstances that there was no such fund in existence on January 1, 1946" (R. 351). The view expressed by the lower courts is clearly erroneous. By making an extra-judicial statement prior to a trial a defendant neither limits the burden of the Government to that of discrediting his statement, nor assumes himself the burden of proving the accuracy of the statement or of proving his opening net worth. The decision below is inconsistent with the dictum of the Court of Appeals for the Third Circuit in *United States* v. *Caserta*, 199 F. 2d 905, where the court, in disapproving of decisions similar to that rendered here, said (p. 907):

> "The cases show, however, a rather *surprising rule* that when the discrepancy between increased net worth and reported income is shown, the burden of explanation shifts to the taxpayer, at the same time repeating the usual criminal law rule that the burden throughout a criminal case is upon the prosecution." (Emphasis added)

To the same effect, see *United States* v. *Demetree*, 207 F. 2d 892, 894 (CA 5).[3]

In view of the confusion among the Courts of Appeals as to the burden of proof in criminal tax prosecution cases

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[3] ". . . Further and more prejudicial to a defendant, there has grown up a kind of ancillary theory that the government, by introducing proof of deposits, expenditures, etc., having put up what it calls a prima facie case, the defendant finds himself jockeyed out of the position the law affords him, of insisting that the government establish his guilt by legal and credible evidence beyond a reasonable doubt. This is accomplished by requiring him to prove himself innocent by assuming the burden of overcoming the prejudicial effect of the mass of exhibits, estimates, conjectures, and conclusions which the government has been allowed to get into the record, upon the apparent theory that it is up to the defendant to explain all of it away as part of his burden to prove his innocence."

based upon net worth expenditures computations, clarification by this Court is required.

D. The Lack of a Proper Instruction on Circumstantial Evidence.

In the present case, the evidence being entirely circumstantial, the petitioners requested the trial court to instruct the jury to the effect that the evidence must be inconsistent with their innocence, excluding every reasonable hypothesis other than that of guilt (R. 227-228). The trial court not only refused to give such an instruction but gave no instruction which adequately defined circumstantial evidence or properly explained the nature or quality of such evidence so as to guide the jury in its evaluation thereof. Instead, the trial court concluded its circumstantial evidence instruction (R. 210-212) as follows:

> "You see this is a complicated case, Ladies and Gentlemen of the Jury, because there is a little bit of circumstantial evidence here, and a little bit of circumstantial evidence over there, and it's going to be your duty, Ladies and Gentlemen of the Jury, to arrive at your verdict on the basis of the facts proven to your satisfaction beyond a reasonable doubt, and also on the basis of the inferences which reasonably may be drawn from those various facts and circumstances in evidence." (R. 212)

This instruction not only failed to explain adequately the circumstantial evidence rule, but might actually have suggested to the jury that the requirement for proof beyond a reasonable doubt did not apply to the inferences which might reasonably be drawn from circumstantial evidence. The court below held that the trial court's instruction was satisfactory, there being no " 'inexorable formulas on the subject' " (R. 351).

The divergence among the circuits with respect to the application of the circumstantial evidence rule has recently been called to this Court's attention in *McFee* v. *United*

States, 206 F. 2d 872 (CA 9), cert. denied 22 LW 3236. However, in the *McFee case*, unlike this case, the trial court while not instructing the jury in the form requested by counsel, nonetheless instructed the jury as follows:

> "Therefore you should consider whether or not the Government has precluded every reasonable source of these funds except earnings for the years charged."

And the Court of Appeals in the *McFee* case concluded that the instruction as given stated the law "with much more clarity and force" than the objection made by petitioner. 206 F. 2d 872, 877. The present case is not one where the trial court simply refused to give a technical form of instruction requested by counsel, but rather is a case where the trial court utterly failed to instruct adequately on circumstantial evidence in any form. This being so, and in view of the nature of the evidence upon which the conviction was here obtained, this case offers an excellent vehicle for consideration and clarification by this Court of the so-called circumstantial evidence rule. Among the cases supporting the position of the petitioners here, and inconsistent with the decision below, are the following: *Garst* v. *United States*, 180 Fed. 339, 343 (CA 4); *Stutz* v. *United States*, 47 F. 2d 1029 (CA 5); *Anderson* v. *United States*, 30 F. 2d 485, 487 (CA 5); *Bryan* v. *United States*, *supra*, p. 226; *Strickland* v. *United States*, 155 F. 2d 167, 168 (CA 5); *McLendon* v. *United States*, 13 F. 2d 777, 779 (CA 6); *Epstein* v. *United States*, 174 F. 2d 754, 769 (CA 6); *United States* v. *Fenwick*, 177 F. 2d 488, 490 (CA 7); *Gurera* v. *United States*, 40 F. 2d 338, 340 (CA 8); *Banks* v. *United States*, 204 F. 2d 666, 672 (CA 8).

E. The Failure of the Court to Instruct on the Essential Elements of the Crime as Set Forth in the Statute.

The trial court not only refused to instruct the jury as to the statute under which the petitioners were indicted, but it completely failed to define and explain properly the

elements of the offense as set forth in the statute. In lieu thereof the trial court submitted to the jury alternative theories of fact, using as its reference point the indictment as distinguished from the statute. The court below, in sustaining the trial court in this respect stated that "the substance of each count in the indictment was recited to the jury . . . every essential element of the crimes charged was placed in issue . . . [and] the offense charged is embodied in the indictment" (R. 349). Thus the court below held that so long as an indictment states an offense, and the text or substance of the indictment is given to the jury, the trial court has fulfilled the requirement that it instruct the jury on the applicable statute. In so holding the decision here is in conflict with the decision of the Court of Appeals for the Ninth Circuit in *Morris* v. *United States*, 156 F. 2d 525, and the decisions of the Court of Appeals for the Third Circuit in *United States* v. *Pincourt*, 159 F. 2d 917; *United States* v. *Levy*, 153 F. 2d 995; and *United States* v. *Noble*, 155 F. 2d 315. In the *Morris* case, involving an alleged violation of the Emergency Price Regulation Act, the trial court failed to define the offense as set forth in the statute instructing the jury in lieu thereof with reference to the facts charged in the indictment. Even though this instruction was not assigned as error, the Court of Appeals there reversed the trial court, holding that "the trial court committed fatal error in failing to instruct the jury on the statutes and regulations defining and governing the offenses charged . . ." (p. 527) The court specifically rejected the suggestion that the requirement of an instruction on the statute could be met by reference to the indictment (Footnote 4 of the Opinion).

The decision below does find support in the decisions of the Court of Appeals for the Second Circuit in *United States* v. *Center Veal and Beef Co.*, 162 F. 2d 766, and *United States* v. *Capital Meats*, 166 F. 2d 537, cert. denied 334 U. S. 812, in which the Second Circuit refused to follow the *Morris* case. On the other hand, the Court of

Appeals for the Third Circuit specifically adopted the rule in the *Morris* case in *United States* v. *Pincourt*, *supra*, p. 919.[4] In view of the fundamental nature of the question, and the divergence of views between the Courts of Appeals for the Ninth and Third Circuits on the one hand, and the Courts of Appeals for the Second and Tenth Circuits on the other, a determination of the question by this Court is required.

F. The Trial Court's Instruction on Reasonable Doubt.

The trial court instructed the jury on reasonable doubt as follows:

> "I have used the term, Ladies and Gentlemen of the Jury, of 'beyond a reasonable doubt.' It is not to be expected that you know what the Court means by that language. So I am going to tell you what I mean. When I say that the Government must bring before you evidence which satisfies your minds beyond a reasonable doubt, the court does not mean that you should understand that the Government has the burden

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[4] "Amendment 9 of the Regulation 445 was not explained, read or mentioned by the District Judge in his charge. Without the governing regulation being made plain to it, the jury could not have an informed judgment on the issue and the case did not go to it under the safeguards of correct procedure. Cf. Williams v. United States, 79 U.S. App. D.C. 299, 131 F. 2d 21, 22. The situation presented goes even further than the facts in the latest reported case in point, Morris v. United States, 9 Cir. 156 F. 2d 525, where the neglect to define the offense in the Court's charge was held not cured by stating to the jury what essential facts if proven would constitute a violation of a specific regulation.

"Three recent decisions of this Court, all of them in much the same type of case as the one under consideration, clearly indicate that the failure of the Trial Court to charge the applicable regulations was substantial error. The first of those opinions, United States v. Levy, 3 Cir., 153 F. 2d 995, concerned a liquor sale under the Price Control Act and its regulations. The District Judge did not charge either the statute or the regulations. As here, the defendant did not object. Despite this we deemed the error so fundamental that we reversed the judgment of the Court below, saying page 998: 'In the instant case the trial court's instructions to the jury did not contain the text of the applicable statute. They included no definite information as to the offense charged. Neither the provisions of the Price Control Act, the regulations under it, nor the substance of either, ever reached the jury. The Court and counsel of both parties were thoroughly acquainted with the law which the defendant was accused of violating, but there is nothing in the record showing that the jury was ever informed as to such prime requisite. The indictment itself states the offense charged by reference to the applicable law but does not set it out in full."

> of satisfying you beyond every doubt, to remove every doubt, leaving no doubt at all. What we are talking about is a doubt based upon reason and common sense, in the exercise of your intelligence. It is a substantial doubt, not a trivial doubt; a significant doubt, not a flimsy one; a real doubt, not an imaginary one. It's the kind of doubt, Ladies and Gentlemen of the Jury, which you folks in the more serious and important affairs of your own lives *might be willing to act upon.* Now if you feel such a doubt about the Government's case, it is your duty to acquit them." (Italics supplied)

While the precise question does not appear to have been considered by any Federal court, the State courts which have considered similar instructions have held them to be erroneous for the reason that "the kind of doubt" is not such doubt as would lead the jury to act, but is that which would lead them to refrain from acting, or to hesitate to act. Assuming, for the purposes of this petition, the propriety of a personal business test in a criminal case (*Hopt* v. *Utah*, 120 U.S. 430), the trial court nonetheless stated the proposition backwards. In *Commonwealth* v. *Miller*, 139 Pa. 77, 21 Atl. 138, the Supreme Court of Pennsylvania made the following observation with respect to a similar instruction:

> "The fifteenth assignment relates to the definition of a 'reasonable doubt.' The learned judge said: 'It is such a doubt as would influence or control you in you actions in any of the important transactions of life.' He did not say that a doubt that would cause one to pause and hesitate was, if fairly derived from the evidence, a reasonable one within the meaning of the criminal law, but that it must be one that would control one's conduct in the important transactions of life. Our actions are determined by the preponderance of considerations. We doubt, hesitate, examine, balance the argument for and against the given action, and act as the preponderance indicates. A doubt that would control our actions in the important transactions of life would be one that was so strong as not to be overcome by the balancing process. Such a doubt

would be practically an unconquerable one. It would lead us not simply to refrain from acting, but to act."

See also *State* v. *Rover*, 11 Nev. 343; *People* v. *Bemmerly*, 87 Cal. 117, 25 Pac. 266; *Lovett* v. *State*, 30 Fla. 142, 11 So. 550.

Insofar as the decision here is in conflict with every State appellate court decision in which the same problem has been considered, and no authoritative Federal decision can be found, a substantial question is presented for this Court's determination.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for writ of certiorari should be granted.

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